4

POLICY RECOMMENDATIONS

4.1. Introduction

This final section reviews the requirements for increasing the competitiveness prospects of Asia-Pacific SMEs within the context of the challenges of the globalization of production, and seeks to provide some specific recommendations on how SME development in the region could be taken in new and potentially fruitful directions. These recommendations seek to address the core question running through this research paper, namely: what can usefully be done to increase the competitive performance of Asia-Pacific SMEs?

As introduced earlier, competitiveness is fundamentally an enterprise-level concept, referring to the relative performance of firms in particular product markets. Nonetheless, the competitive performance of enterprises is shaped by a country's: (a) endowment; (b) macroeconomic conditions, including a country's policy and institutional environment; and (c) microeconomic factors, including the quality of a country's business environment, the relative sophistication of a firm's operations, and the state of enterprise cluster development in a particular economy. Given the challenges of current trends in the globalization of production, attention must be focused on the requirements of enterprise linkages and network efficiencies, and on upgrading options (for example, product and process innovation) as key dimensions of the competitiveness of Asia-Pacific SMEs.

Within this context, it is possible to identify a range of activities that can contribute to strengthening the prospects for the competitiveness of SMEs. As noted, Asia-Pacific economies vary greatly in terms of their characteristics and levels of development. In general, there are three types of economies in terms of SME support requirements: (a) economies with significant and widespread deficiencies in basic infrastructure, and constraining policy, institutional and regulatory environments; (b) economies with less severe or urgent deficiencies in the "basics" (for example, relatively good infrastructure, and adequate policy and regulatory frameworks) but some relatively weak key institutions; and (c) economies that have good basics for production activities (manufacturing and/or services) and a relatively efficient SME support structure, but that require further strengthening of particular policies, institutions and support services. Therefore each country has to pick the appropriate mix of policies, programmes and institution-building initiatives to be undertaken by the government and private sector, and supported by international development partners.

4.2. A role for government

The case for government intervention to assist SMEs is anchored in the assumption that significant market failures prevent domestic small enterprises from building the capabilities necessary to participate in global value chains. These are assumed to arise because of weaknesses or disadvantages that SMEs are perceived to have relative to large firms—and their peers in other countries—in accessing key resources and services such as finance, information, technology and international buyers. Therefore, specific policies, programmes and institutional frameworks are seen as needed to assist SMEs in overcoming market failures. In this context, a public policy or publicly financed programme to support SMEs must be anchored in a sound economic rationale.

While such a programme is necessary, alone it is not sufficient for an appropriate public policy or publicly financed SME support programme. Special-purpose policies and programmes, particularly if they involve subsidies in some form (for example, transfers from general taxpayers to special targeted interests, such as SMEs), carry the risk of creating economic distortions, for example with regard to business incentives. Therefore, it must also be demonstrated that such initiatives are likely to lead to net welfare benefits for society as a whole. From this perspective, examples of market failures cited as causing a bias against SMEs and requiring a public response include the following:

- Asymmetric information on SMEs, (available to formal financial institutions, for example) and distortions in credit markets (such as in the operations of the banking system) restrict SME access to financing;
- Relatively higher costs of training and technology development, along with the inability to appropriate the full benefits of such investments, cause underinvestment by SMEs in training and in technology acquisition and development;
- Smallness creates relative cost disadvantages for SMEs to an important extent because small enterprises have a significantly weaker voice than larger firms, in terms of influencing policy and public expenditure decisions, because of, among other things, constraints on their participation in public-private institutions and dialogue. As a consequence, policies and regulations often impose disproportionately high fixed costs on small firms;
- Small size limits capacity-building options, for example restricting relative access to costly support services (consulting, financial, legal, training, among others) and information, limiting SME productivity and therefore competitiveness.

The above are all fairly generic and perennial adversities encountered by SMEs in virtually all economies, both developed and developing.

An effective public policy and programming framework for Asia-Pacific SMEs should begin with an understanding of constraints and possible solutions—as perceived by SMEs themselves. A useful way of identifying such constraints is by giving a voice to SMEs in appropriate forums for dialogue with government. This, in turn, requires recognition by governments of the need for effective channels of communication with small enterprises, not only the large firms that are the usual participants in national chambers of commerce and federations of industry in the Asia-Pacific region. This can be pursued in a number of ways, including outreach to SME associations and other business associations that have a large SME membership. At the same time, it has to be informed dialogue. In a recent study that surveyed SMEs about their perceived needs, OECD reported that enterprises indicated a lack of government support for facilitating their participation in global value chains. However, the study then went on to suggest that SMEs responded in this way because they had "…limited understanding of the global environment and therefore cannot easily identify policy initiatives facilitating their effective participation in global value chains" (OECD 2007, 6), for example, existing and readily available SME skill upgrading programmes.

A generally supportive macroeconomic environment for enterprise development includes low budget deficits, appropriate inflation management, competitive real exchange rates, and an outward-oriented trade regime. The macroeconomic environment needs to be particularly stable and predictable from the perspective of small firms, as fundamental unexpected policy changes may threaten the viability of SMEs more readily than that of larger firms (which have a larger resource cushion). The experience of Asia-Pacific economies with financial liberalization and exchange rate adjustments provides suggestive examples.

Furthermore, it may be necessary to put in place economic and financial safety nets for SMEs to prevent the large-scale macroeconomic and financial disruptions experienced during the Asian Crisis; this is increasingly important in the context of the present global financial crisis and its expected impact on Asia-Pacific exports.[32] Beyond macroeconomics, a clear, fair and stable legal and general regulatory framework is also essential, providing SMEs with the assurance that government will not discriminate against small firms in the interpretation, implementation or enforcement of laws and regulations, and that it will provide a framework for fair competition with respect to, among other things, commercial transactions, intellectual and commercial property rights, the tax code and labour legislation.

It is also important that FDI promotion policies and programmes facilitate the integration of domestic SMEs into global value chains, consistent with an economy's comparative advantage. An important dimension here includes initiatives to attract new types of MNEs that may not be household names, but that play a pivotal role in managing global production integration in specific value chains of particular relevance to a given economy, such as Flextronics in the electronics and ICT space. In this context, it is essential to ensure that import/export regulations and procedures are efficient and consistent with global value chain-related requirements of the strategies and operations of such global suppliers. Estonia and Ireland are examples of countries that are taking effective GVC-related approaches to FDI that could be instructive to Asia-Pacific economies.

4.3. Improving the micro-environment for SME competitiveness

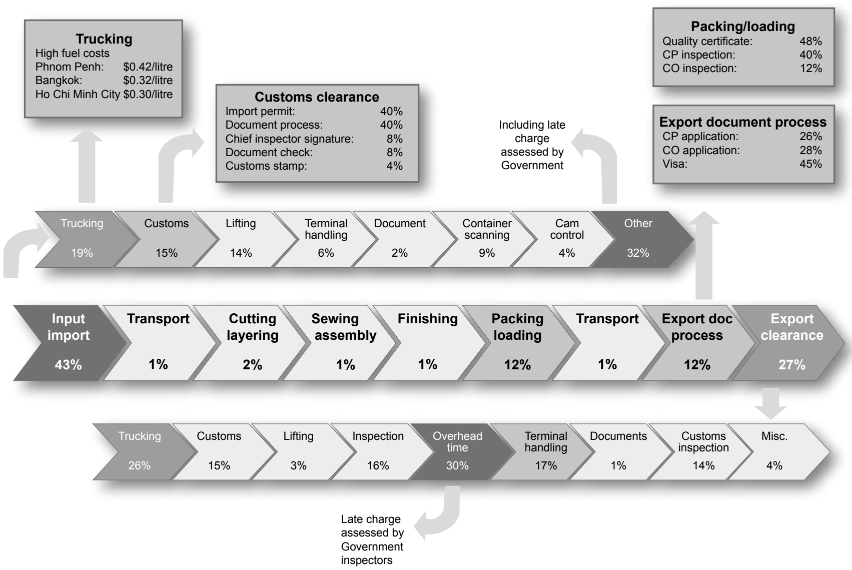
4.3.1. Quality of the business environment

Creating a business-friendly environment for SMEs is a critical requirement for enhancing the general competitiveness prospects for small firms. This includes: (a) ensuring the relative ease of entry and exit of new firms (see section 1 for a discussion of this issue); (b) simplifying import-export policies and procedures, particularly from the perspective of small firms and in the case of small economies; (c) streamlining bureaucratic rules and procedures that hinder the expansion and export potential of SMEs; (d) assessing the costs and benefits of specific regulations that could place a disproportionate burden on small enterprises; and (e) implementing regulations with

[32] At the time of writing, Viet Nam seemed poised to allocate a proportion of its $1 billion stimulus package to a new SME credit guarantee fund—a somewhat controversial move.

attention to the flexibility needed by SMEs. Focusing on trade facilitation issues, such as streamlining and improving customs procedures and regulations, is particularly important in the context of providing SMEs with access to participation in global value chains. The application of value chain analysis to identify constraints in import/export procedures is illustrated in figure 10 in the context of Cambodian garment exports (denim jeans), which are especially reliant on the import of parts and components.

Figure 10. Value chain analysis of denim jeans exports from Cambodia: implications of import-export procedures



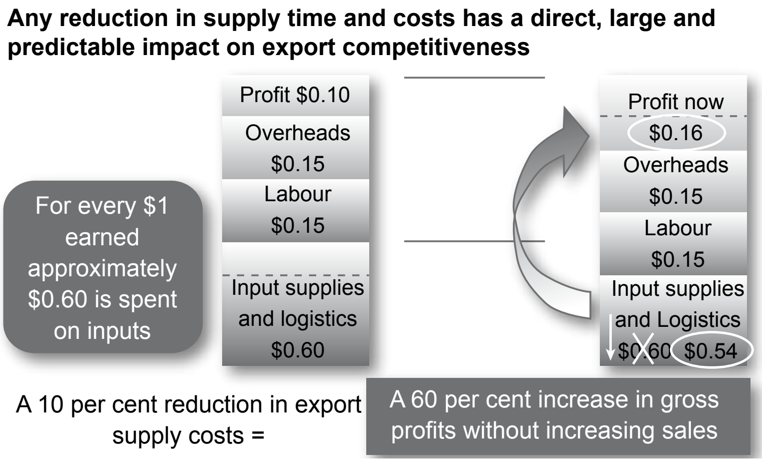
Source: World Bank, *Towards a Private Sector-Led Growth Strategy for Cambodia,* prepared by Global Development Solutions LLC (Washington D.C., 2003), Chart 10, p. 71.

Abbreviations: CO, Certificate of Origin; CP, Certificate of Performance.

Competition within the framework of global value chains hinges on the efficiency of logistics systems that link geographically distributed producers and buyers. Some Asia-Pacific economies, out of necessity, need to concentrate at this stage on building critical basic infrastructure, such as airports, highways, ports and telecommunications/ ICT systems. However, it is essential to begin to focus simultaneously on the less visible requirements of improving the flow of goods through an economy, including across borders. This includes addressing issues related to the institutional, legal and regulatory environment of transport services such as, among others: (a) consistency with international rules to ensure transparency and predictability; (b) efficiency of multi-modal transport linkages; (c) containerization; (d) load and warehousing centres; (e) hub and feeder networks; (f) e-communications and e-commerce; and (g) a linking of logistics services to improvements in trade facilitation procedures (such as customs rules and procedures). This requires a “logistics perspective” from the outset, particularly one that explicitly recognizes the particular constraints and needs of SMEs.

For example, small enterprises require reliable access to externally provided logistics services that seamlessly link production with distribution and that can handle the distinctive needs of small-batch producers, including special purpose systems such as refrigerated trucks and pre-cooled storage facilities for fresh fruit and vegetables. An example of such a logistics perspective as the basis of public policy and public-private partnership, including a focus on the particular needs of SMEs, is provided by South Africa (see, for example, CSIR 2005). The impact of even marginal improvements in logistics and trade facilitation services on profits and competitiveness is illustrated in figure 11.

Figure 11. Improvement in logistics + trade facilitation = competitiveness and profits



Source: Ian Sayers, *Trade Facilitation in Export Delivery Supply Chains* (Geneva, International Trade Centre, 2003).

Financing is generally cited by Asia-Pacific SMEs as a critical factor determining viability and growth. As noted, commercial banks and investors have been reluctant to finance SMEs in the region, or when they do provide funds they charge a significant premium. This is due to factors associated with small firms, such as high perceived risk, higher transaction costs (per amount lent), incomplete accounting records, inadequate financial statements, and weak business plans. These general problems of SME financing in the region have received considerable attention (see, for example, Beck 2007 and Ferranti and Ody 2007). The general financing constraint is particularly important in the context of the participation of Asia-Pacific SMEs in global value chains. As discussed, such participation often requires substantial investments in developing appropriate production technologies, logistics services, skills, capacity expansion and certification to meet a variety of stringent global standards. Working capital requirements can be especially challenging for small suppliers in GVC-oriented production networks. Suppliers in GVCs may not receive payment from their (often bigger) customers until weeks or even months after the delivery of orders. With the shift from letters of credit, which allow bank financing of the working capital needs of SMEs, to the increasing use of unsecured open account finance, SME suppliers face additional financing constraints and risks. Payment delays and, in the event of further complications, contract enforcement and collection of late payments, can be particularly significant challenges for a small firm.

Therefore a key requirement is for financing mechanisms that can help small suppliers overcome liquidity constraints, for example through the increased use of creative financing services such as equipment leasing, factoring (the purchase of a firm's accounts receivables), and securitization of SME loans, as in the case of Bangladesh, the Republic of Korea and Singapore. Wider use may also be made of guarantees from multilateral development banks, for example to enhance credit ratings of securitized SME loans in Asia-Pacific economies. Additional measures could include providing legal assistance to suppliers negotiating contracts, providing legal protection against unfair (payment) practices, and shortening payment delays for local SME suppliers through legislation or fiscal incentives. An exploratory initiative to establish business-angel networks in one or more Asia-Pacific countries might also have merit, possibly working in conjunction with established business associations.

In other areas of SME development, identifying ways of addressing the gender imbalance between SME owners is one field that probably has not received as much attention as it might (beyond basic gender mainstreaming), at least in those countries where the asymmetry is most apparent. Similarly, in some countries where this is pertinent, there has perhaps been insufficient attention paid to the paucity of robust SMEs in areas belonging to minority ethnic groups and/or remote or economically depressed areas, where this is seen to be a problem. Subregional and country-specific initiatives in areas such as eco-tourism and handicrafts—such as "stay another day" interventions—may have utility in this regard.

Cultural and social issues relating to risk-taking in business, and the stigma of business failure, also tend to get limited coverage beyond the academic community of researchers, as does the promotion of an entrepreneurial culture in a country. Initiatives designed to identify and then support the entrepreneurial framework conditions of Asia-Pacific countries would be worthy of pursuit. Possibly a good starting point would be to support the inclusion of more Asia-Pacific economies in the Global Entrepreneurship Monitor exercise. An alternative would be to design a regional equivalent, intended to serve as an evidence-based diagnostic platform on which to pursue some specific interventions, on a national or subregional basis.

As yet, there has been relatively little attempt to take the creative economy approach to SME development in Asia-Pacific developing countries. In 2008, UNDP and UNCTAD (2008) co-published the *Creative Economy Report 2008,* which seeks to explain the thinking behind the (still evolving) creative economy approach.[33] As the report

[33] Definitions of the creative economy tend to differ, although a good point of reference might be a context in which: "… the interface among creativity, culture, economics and technology, as expressed in the ability to create and circulate intellectual capital, has the potential to generate income, jobs and export earnings while at the same time promoting social inclusion, cultural diversity and human development" (UNDP and UNCTAD 2008, iii).

intimates, the creative economy concept is particularly pertinent—and enticing —for cities or regions (as opposed to whole countries) that already host resource wealth in terms of the creative arts, education, culture and history. Some of the issues raised in the report are highly pertinent to SME development, and would merit some exploratory research work in the Asia-Pacific region, perhaps focusing on some cities that have a strong cultural legacy, but that, with the possible exception of tourism (which is a critical ingredient in the creative-economy mix), have arguably underperformed economically. Cities such as Luang Prabang and Hue, in the Lao People's Democratic Republic and Viet Nam respectively, immediately come to mind.

Indeed, the whole issue of business innovation (and entrepreneurship), and how to promote it, usually does not feature prominently in more conventional SME development initiatives in developing countries—particularly in those that are least developed. (One notable exception is Bhutan and its "Tenth Plan" (Bhutan 2009), which seeks to support SME development in part through the promotion of greater business innovation and creativity, focusing in particular on niche products.) SME development programmes are often focused most on poverty alleviation and making household enterprises more sustainable and formalized. While of undoubted merit, such interventions may not add significantly to a country's overall economic competitiveness and long-term growth trajectory. Initiatives that seek to acknowledge and reward innovation and creativity among SMEs and entrepreneurs, either at the regional or national levels, could be a useful catalyst in promoting productivity within domestic business communities.

Furthermore, innovation and creativity in business is virtually impossible to achieve if adequate intellectual property rights protection (both regulations and their effective enforcement) is not in place. And yet the issue of intellectual property rights is not often given prominence within many SME development programmes, possibly because of the perception that it is something most keenly pursued by multinational enterprises, to the detriment of local SMEs. Regional and national initiatives aimed at raising awareness of intellectual property rights could be of merit for SME sector development, and could improve the wider enabling environment for business as a whole.

Another area that receives relatively less attention is that of SME exits, including bankruptcy. The notion of technical assistance that assists in the orderly closing of small firms, and the efficient recycling of assets, may not appeal to policymakers and development partners that do not wish to be seen as "corporate undertakers". But the issue is an important one, as discussed earlier. If financiers are to lend to SMEs, and entrepreneurs are to take the professional (and socio-cultural) risk of starting up new business ventures, then there needs to be a transparent and efficient means by which less competitive SMEs can close down, and more competitive SMEs can then enter that space. There is also scope for more work in helping developing countries to create markets for SMEs, so that new market entrants and/or investors have the option to acquire existing companies, rather than establish wholly new ventures. Sadly, this may be an increasingly vexing issue in the next few years, as the global economic downturn takes its toll on numerous Asia-Pacific SMEs.

4.3.2. Sophistication of enterprise operations and strategy

Business development services.[34] Governments and donors in Asia and the Pacific have focused on providing business development services (BDS) for SMEs to help overcome perceived market imperfections. BDS refers to all types of SME support services, including: (a) training in business-related skills; (b) counselling and consulting; (c) technology development and transfer, involving the adaptation, design and development of appropriate technologies; (d) information on markets, buyers and technology; (e) business linkages, including between SMEs and large firms (subcontracting, for example) and among SMEs (such as the development of enterprise clusters); and (f) financing. As discussed in Abonyi (2007), the “market development paradigm” is now the most widely used organizing framework for the provision of BDS. It involves creating a market for a diverse array of services, with government and donors playing the role of facilitators for privately provided BDS. The basic assumption is that BDS can be best provided not directly by governments and donors, but by well-developed markets for such services on a commercial basis, even for the lowest income segments of the SME sector. The experience with this approach to BDS has been mixed to date.[35]

The rest of this section touches briefly on selected business development services of particular relevance for strengthening the prospects of participation of Asia-Pacific SMEs in global value chains.

Understanding global value chains. SMEs traditionally serve local markets. Therefore they generally have a limited understanding of the opportunities global value chains could provide for small enterprises, and of the corresponding structure, dynamics and requirements of subcontracting to foreign buyers within the framework of GVCs. Given the limited resources and restricted managerial capabilities of small firms, it is generally both difficult and expensive for SMEs on their own to obtain such information. Increasing the competitiveness-related sophistication of Asia-Pacific SMEs then has to begin with familiarization with the potential benefits and operational requirements of engaging with international buyers in the context of particular global value chains.

Standards and certification. Access to global markets through GVCs depends increasingly on meeting a range of stringent standards, confirmed through a credible certification of: (a) inputs (sourcing of wood for furniture, for example); (b) products (such as safety and health standards); and (c) production processes (such as labour standards). International buyers generally look to source from certified companies as an indication that the minimum required capabilities are present. Where testing and inspection is not carried out by the GVC buyer, suppliers must be able to prove the reliability of their inspection procedures, test data and conformity with international standards. The costs of certification and compliance with an increasing number and variety of standards may be relatively high for SMEs. But meeting such standards provides potential access to international markets, and strengthens the general competitiveness of SMEs by improving their production-related capabilities. Governments (and development partners) can support the availability of certification systems, and help ensure that they do not impose a prohibitive burden on small enterprises. SPRING Singapore, a government agency for fostering a competitive

[34] This section is based on Abonyi (2007).

[35] See Abonyi (2007) for a more detailed discussion of business development services, particularly from the perspective of SME participation in global value chains.

SME sector, is a good example of this; among other things, it publishes a highly informative (50-page) guide for SMEs: Make Standards Work for You. Similar guides for SMEs in other Asia-Pacific countries would undoubtedly be of use. Furthermore, the use of clusters (see below) can provide a mechanism for group certification for small enterprises, increasing the likelihood of a sufficient "supply" of certification services, and reducing their cost.

Government procurement. In many Asia-Pacific countries, State agencies are a major source of revenues for companies, but SMEs often struggle to qualify as suppliers to State-run procurement departments, for a host of reasons. This excludes them from a potentially large client base. Governments, and SME development agencies in particular, could do much to make their procurement policies more transparent and inform the SME community about the criteria necessary to become an approved supplier. Here again, SPRING Singapore is a good example, providing SMEs with a user-friendly guide on government procurement, published in conjunction with the Ministry of Finance. (Not only is such an initiative useful for SMEs, it also obliges State agencies to streamline their procurement policies, from which various efficiency and cost gains can be derived.) Governments can also review their procurement policies to ensure that they do not needlessly discriminate against SMEs.[36]

Technology upgrading. If they are to improve their competitiveness prospects in the context of global value chains, SMEs need to upgrade their technological capabilities and sophistication in areas such as production layouts, productivity improvements, raw material testing, quality standards and management, metrology, information systems and other technical services. Supporting measures could include: (a) providing financing to enable SMES to obtain technical certification; (b) establishing productivity centres specifically for SMEs; (c) setting up technology-related training services; (d) promoting partnerships between SMEs and technical institutes; and (e) supporting public technology institutions in developing special services aimed at small enterprises.

Of particular importance to SMEs is the adoption of modern ICT technologies that are essential for participation in global value chains, and that can also enhance the general competitive performance of small firms by reducing their costs and time, and by extending their reach and coverage. In particular, ICT can: (a) improve management efficiency by strengthening the organizational capability to process large amounts of data at a relatively small cost; (b) allow small firms to access key information and analysis that has traditionally been available to larger firms, on, among other things, markets, customers and competitors; (c) strengthen the operational efficiency of small firms, through, among other things, more efficient inventory management, ordering, and scheduling; (d) enable SMEs to provide effective after-sale services and support to maintain customer contact and loyalty; (e) increase the capabilities of SMEs for in-house product and process innovation; and (f) leverage existing capabilities and capacity of individual small firms to reduce the advantage of the scale economies of larger enterprises, for example by opening options for new partnerships and linkages.

[36] With the current global economic downturn prompting many governments to increase their spending through stimulus packages and the like, in a Keynesian strategy to support their domestic economies, SMEs would be well advised to make efforts to become acquainted with government procurement procedures.

Skills development and training. Participation in global value chains is likely to require a generally higher level of threshold skills from SMEs. Therefore policies and programmes aimed at raising technical and managerial skills can increase the prospects of SMEs to be competitive suppliers in global value chains. This may be supported by training schemes, information campaigns to educate SMEs about the benefits of increased training and skill development, tax breaks for training, and special-purpose courses in local training institutions. An example of a comprehensive training programme aimed at upgrading SME skills is provided by SPRING Singapore, which, among other things, is the national standards and accreditation body aimed at enhancing competitiveness:

> The SME Training for Enhanced Performance and Upgrade (Step-UP) programme is an initiative by SPRING Singapore and the Singapore Workforce Development Agency to address the training needs of small and medium enterprises (SMEs). It aims to identify the training gaps and relevant courses for SMEs, focusing on industry and occupational skills that are immediately applicable to the workplace.
>
> These courses will offer targeted training with defined end results to help SMEs develop new capabilities and raise the overall industry standards. SMEs that send their workers for such training will enjoy enhanced course fee support from the Skills Development Fund.
>
> To kickstart the programme, SPRING Singapore and the Singapore Workforce Development Agency will work with the industry associations supported under the Local Enterprise and Association Development programme (LEAD) to identify industry-relevant courses.[37]

Information "brokerage". Domestic SME suppliers need to understand the requirements of buyers at different levels in specific global value chains. Government agencies can sometimes play an important role in bringing together MNE buyers (such as Danon, Carrefour, Flextronics, Li & Fung) with potential domestic suppliers—or related business associations—in order to help SMEs understand the requirements of becoming a supplier in GVCs. At the same time, as domestic SME suppliers upgrade their capabilities, government can play an important role in providing information to MNEs on supplier capabilities. The Penang Skills Development Centre in Malaysia is example of an institution that plays this kind of a two-way information brokerage role effectively in the electronics/ICT industry; it also provides a related capacity-building role for SMEs.

Corporate social responsibility and the environment. Congruent with growing concern about the environment and climate change (impact, mitigation and adaptation), there has been relatively little research and technical assistance done in the area of sustainable business for the SME sector. For many SMEs themselves, the notion of having to comply with an increasingly burdensome array of regulations pertaining to the environment is, at first glance, not an attractive proposition. Indeed, it threatens to become yet another set of compliance costs, both informal and formal. While such a perception is understandable, it does belie the opportunity for SMEs to leverage a sustainable business model to competitive advantage, in a number of ways. For example, local SMEs with ISO 14000 accreditation are more likely to attain linkages with foreign-invested enterprises. And export-oriented SMEs that are able to pass a spectrum of environmental audits are

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[37] See the SPRING Singapore website at www.spring.gov.sg/Content/WebPage.aspx?id=f68177c9-2dca-4ec2-b6a7-d7ce086962e4.

much more likely to: (a) have their products sourced from international buyers; and/or (b) participate in international production networks.

As institutional and retail investors, as well as retail customers, become increasingly attuned to sustainability issues, issues of price competition for SMEs in developing countries will become more diluted, and replaced by the extent to which they comply with various community and environmental standards. For an SME competing globally, this can be a welcome escape route out of a zero-sum game of accelerating price competition and ever-diminishing profit margins, and a means by which to trap more of the value chain through its brand. And yet many SMEs have little knowledge of this trend, or how to adjust to best effect. There is a need for guidance on this topic, ranging from: (a) how to be compliant in terms of current national and international regulations; through to (b) how to proactively embrace community and environmental standards for competitive advantage.

Codes of conduct for corporate social responsibility. Recent difficulties in the toy and food global value chains highlight the problems of supplier compliance to global standards. When suppliers are unable to meet global standards, related to safety or labour for example, the production network as a whole suffers the consequences. It is important to have a regional forum for supporting best-practice monitoring in the Asia-Pacific region within the broader framework of corporate social responsibility. An effective example of how this can strengthen SME competitiveness is the Cambodian experience in the apparel and garment industry, where the International Labour Organization has acted as an informal monitor, in effect certifying Cambodian garment factories as adhering to high labour standards, supported by capacity-building through the Foreign Investment Advisory Service, thereby strengthening the competitive performance of Cambodian enterprises in this sector.[38]

4.3.3. Enterprise clusters[39]

The investment requirements of participation in global value chains and the constraints of size, discussed above, can make it difficult for individual SMEs to be competitive as international suppliers or to upgrade within production networks. However, through focused cooperation, local suppliers can gain collective efficiencies based on scale (input purchases, for example), specialization (such as producing different parts of a given product) and joint action (such as joint marketing). This enhances their “attractiveness” as suppliers by reducing transaction costs for international buyers sourcing from these firms.

Enterprise clusters are, then, groups of enterprises in the same or related value chains who cooperate to compete. The collective efficiencies gained through cluster-based cooperation, for example in complementary areas of specialization and/or pooled production capacity, can help local SMEs as a group enter and/or upgrade in global value chains. For global suppliers such as Li & Fung in garments, or for global retailers such as Carrefour in fresh fruit and vegetables, SME clusters lower the transaction costs of input collection and marketing output. In technologically more complex GVCs (such as for automotive parts, electronics and ICT), clustering allows the collective sharing of investments needed by subcontractors in process and product upgrading, for example,

38 See for example Sok Siphana (2005) and FIAS (2005).

39 For a comprehensive discussion of clusters see Abonyi (2007), on which this section is based. See also Andersson and others (2004) and Das (2008).

acquiring and adapting new equipment, that would be beyond the technical or financial capabilities of individual SMEs. Membership in clusters therefore can enhance the productivity, innovation potential, and competitive performance of SMEs, and allow small enterprises to combine the advantages of smallness (flexibility) with the benefits of size (economies of scale and scope). Clustering increases the effective size of the market and reduces the cost of market access for cooperating SMEs. Furthermore, the existence of supplier clusters in particular industries can also provide competitive locational advantages for attracting GVC-related FDI. Operationally, clusters represent a range of partnerships and linkages, as summarized in table 16.

Table 16. Cluster linkages and partnerships

Types	Description
Vertical supplier linkages	Relationship with (global) customers or higher-tier suppliers to provide better services
Horizontal informal links	Contacting other firms for information, assistance, referrals and learning; contacts built up through trust over time
Horizontal formal collaboration	Collaboration among firms for joint activities (for example sourcing and production) supported by formal agreements
Formal associations	Membership clubs, trade associations and networking groups, such as those set up by service providers, and benchmarking
Gaining access to common assets/resources	Government agencies and other support institutions that provide needed services, education and infrastructure

Source: George Abonyi, *Linking Greater Mekong Subregion Enterprises to International Markets: The Role of Global Value Chains, International Production Networks, and Enterprise Clusters* (United Nations publication, Sales No. E.07.II.F.2).

The critical success factor for clusters is the existence of effective institutions, particularly at the industry level, that facilitate the variety of linkages, such as those: (a) among SMEs; (b) with international buyers; and (c) with government agencies and other support organizations. Successful examples of such institutions include the Surgical Instrument Manufacturers Association of Pakistan in Sialkot and the Sialkot Chamber of Commerce and Industry (Pakistan), the Tirupur Exporters' Association (India), and the Penang Skills Development Centre (Malaysia) (see Abonyi 2007 for a discussion of clusters in the context of global value chains).

Landlocked Bhutan, with its considerable transit constraints, is just one country that is embracing the cluster concept as part of its strategy for both SME development and wider economic development. The Government has identified three industrial parks (Dhamdum, Motanga and Jigmeling), and two dry ports (Gelephu and Samdrup Jongkhar) for initial focus as strategic growth centres, with a mandate to catalyse SME development. It is also beginning to examine the potential for business incubators to support new and entrepreneurial SMEs in prospective sectors.

4.3.4. Subregional cooperation

Subregional cooperation that focuses on production integration within the framework of global value chains can make potentially important contributions to strengthening the competitive performance of Asia-Pacific enterprises, particularly SMEs.[40] Such cooperation can support the development of cross-border partnerships among enterprises, strengthening their competitive performance and the investment attractiveness of the respective economies. To date, subregional cooperation programmes such as the Greater Mekong Subregion Economic Cooperation Program and the Central Asia Regional Economic Cooperation Program have focused primarily on strengthening physical connectivity through cross-border infrastructure and related "software", particularly trade facilitation. There may be merit for similar initiatives within the members of the South Asian Association for Regional Cooperation, and across the island economies of the Pacific. For smaller economies where the domestic hinterland is limited, such as Bhutan, the Lao People's Democratic Republic, Nepal and most Pacific island States, such initiatives could have a significant and positive impact on SME development by helping to improve critical export performance.

Various other programmes have also touched on areas such as tourism (including eco-tourism and "stay another day" initiatives), human resource development, and cooperation on public goods such as environment and health (including initiatives by the Greater Mekong Subregion Economic Cooperation Program). This has helped strengthen the competitiveness of enterprises in these subregions by, among other things, improving cross-border transport and trade linkages. The Asian Development Bank, for example, is to commence the Greater Mekong Subregion Sustainable Tourism Development Project, with a goal of "sustainable tourism development that creates livelihood opportunities for the poor". It will be enacted across nine provinces of the Lao People's Democratic Republic and five provinces of central Viet Nam. One of its core outputs will be to make operational "pro-poor, community-based, supply-chain tourism projects", across 33 subprojects.[41] This project may well serve as a model for replication in other subregions.

However, there has been limited focus to date on the integration of subregional production within the framework of global value chains (the key drivers of East Asian economic growth and integration), as a way of strengthening the competitive performance of Asia-Pacific enterprises, particularly SMEs. Focusing on an integration of subregional production that involves cross-border production partnerships, and related areas such as cross-border logistics, standards and certification, and enterprise clusters, is especially important for small enterprises in lagging economies that are not well connected to regional production systems and international markets. Such integration could provide potential building blocks towards integrating SMEs in a subregion into wider international markets. While some work has been conducted in this area, such as the technical

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40 See Abonyi (2007) for a suggested framework for GVC-oriented subregional cooperation in the Greater Mekong Subregion, with particular focus on SMEs.

41 See www.adb.org/Documents/Profiles/GRNT/38015022.ASP. More specifically, it "includes the development of tourism products and tours designed and operated by local communities in partnership with the private sector, and supply-chain initiatives to link the production of agricultural goods and handicrafts by poor communities to the local, regional, and national tourism economy. … The output aims to increase rural employment and the incomes of the poor by developing new tourism products and services in partnership with the private sector. New opportunities will be developed to produce and sell local handicrafts, food, and other products to tourists."

assistance provided under various SME development programme loans enacted by the Asian Development Bank, it has been done principally on a country-by-country basis, and not on a subregional level.

As touched on in section 3, among the countries of the Asia-Pacific region there is the risk of “beggar thy neighbour” policies aimed at promoting domestic SME suppliers to international buyers and investors. It may be useful to have an effective forum at both the subregional level (the Greater Mekong Subregion, for example) and regional level (such as the ASEAN Free Trade Area) to discuss the options and implications of regional production integration. In particular, such a forum could focus on how to rationalize individual country policies within a broader framework of intraregional specialization—in particular GVCs—in a way that is consistent with the World Trade Organization.

4.3.5. A proposed programme of action

Finally, we conclude this section, and the paper as a whole, with an indicative programme of action for an international agency like ESCAP, based on the analysis and policy recommendations provided above. It is primarily focused on improving the competitiveness of SMEs in the Asia-Pacific region, specifically within the context of increasing globalization of production and the resulting need to participate in global value chains.

As noted previously, SME (and private sector) development tends to be a fairly crowded field of activity for policymakers, State agencies and international development partners of various hues. So this programme of action focuses on areas where we believe there is currently a gap or paucity of useful initiatives, and therefore where some real “additionality” could be achieved. As intimated earlier, there is a tendency for policymakers and development partners to (quite understandably) focus most of their attention on overcoming the hurdles that prevent initial market entry by new SMEs. And there is a definite need for these kinds of initiatives in many Asia-Pacific economies.

However, for some countries at least, diminishing returns from activities are becoming apparent in this field, and there is probably a greater need for initiatives that assist SMEs in upgrading into more robust and sustainable business entities—in becoming medium and large enterprises, in other words. That is arguably an even greater challenge for many SMEs, for a host of reasons. And yet there can be a tendency for policymakers in particular to focus more on headline numbers for new business start-ups and incorporations. But if those headline numbers are derived in large part by SMEs splitting into two or more business ventures, or inflated by the fact that failed companies are not being logged, then they depict a false El Dorado. More importantly, they also miss the point when one considers that in today’s international business environment, SMEs need to graduate to a level where they can establish linkages with global value chains and become active members of these GVC communities. Establishing a greater number of SMEs should not be seen as the end, but rather a means to an end: a robust, varied and vibrant corporate community, comprising business entities of many different forms and sizes.

With the above in mind, the indicative programme of action focuses on interventions that might be most fruitful in some of the less developed subregions of Asia and the Pacific, based on useful lessons learned in some of the more developed economies of the region.

It also seeks to be innovative in its approach, albeit based on robust and evidence-based research. That then means the interventions are mostly of an entry-level kind, intended to serve as an initial platform, from which a more long-term programme could be developed and sustained over time.

The programme of action comprises: (a) six components directly pertaining to the globalization of production; and (b) four slightly more generic pro-SME initiatives that we suggest have tended to be overlooked in SME development activity, and that also could have particularly strong impacts during this current global economic slowdown. The 10 components are by no means mutually exclusive; indeed, there is a strong degree of overlap and complementarity between some of them. Nonetheless, we would suggest that each one focuses on an important issue or topic that would be of benefit for SME development efforts in the Asia-Pacific region.

PROPOSED COMPONENTS OF A PROGRAMME OF ACTION

1. A detailed survey and diagnostic analysis of logistics networks (as opposed to physical infrastructure) in select subregions of the Asia-Pacific region, to: (a) identify; (b) gauge the extent of; and (c) propose ways to address weaknesses in these networks that are cumulatively serving to constrain the ability of SMEs to "plug into" and better integrate in global value chains and production networks. The fruits of this empirical research could then be disseminated and discussed in various specialist forums, attended by relevant stakeholders, leading to a set of specific recommendations and actions relating to logistics. Such an intervention might be expected to have the most impact in some of the landlocked and less developed States of mainland Asia, and some of the island economies of the Pacific, likely pursued on a subregional basis.

2. A project designed to support the conceptualization, design and piloting of new enterprise clusters in select (and pertinent) value chains, with the primary aim of forming groups of SMEs in complementary fields of specialization that could then better plug into global value chains. This would probably need to be pursued at a national level, possibly focusing on economies and SME communities identified as being most likely to benefit from such an initiative. But there may also be some potential for subregional initiatives, where existing frameworks, such as the Greater Mekong Subregion Economic Cooperation Program and the Central Asia Regional Economic Cooperation Program, already exist.

3. A project intended to foster and support the development of cross-border partnerships among SMEs at the subregional level, with the aim of strengthening competitive performance. Again, this could build on existing subregional initiatives, such as the Greater Mekong Subregion Economic Cooperation Program and the Central Asia Regional Economic Cooperation Program, which until now have focused more on strengthening physical connectivity. The intervention should also develop subregional forums that could explore ways to rationalize individual country policies (relating to SME and industrial development) within a broader framework of intraregional specialization in relevant global value chains.

4. An intervention aimed at increasing awareness and knowledge among Asia-Pacific SMEs on standards and certification and their increasingly crucial role as "pass keys" to entering global value chains. The project would be aimed directly at SMEs, providing

detailed information and practical guidance on the (sometimes quite daunting) world of standards and certification, ideally in conjunction with relevant business associations, chambers and SME development agencies. Such an intervention is likely to be focused around key and/or prospective business sectors, with seminars, documentation and other materials distributed to SME communities in select subregions. Ideally, it would be useful to get relevant MNEs from pertinent sectors directly involved in this intervention (for example, participating in some of the seminars and printed materials), so that SMEs could see the benefits to be derived; hopefully, such MNE participation would also provide a platform for the establishment of business linkages.

5. Improvement of the framework conditions for entrepreneurship and business innovation. Relatively little has been attempted in seeking to foster and promote entrepreneurial endeavour and business innovation among SMEs and new ventures. There is a need to identify what specific framework conditions are missing in select economies or subregions, possibly using the methodological approach adopted by the Global Entrepreneurship Monitor surveys. This could then lead to a set of specific recommendations on how select economies could pursue enabling environment policies that would encourage a more vigorous and vibrant entrepreneurial community of potentially high-growth SMEs to develop and blossom. Further, more research work needs to be done on the nexus between SME development, innovation and the creative economy, possibly focusing on specific municipalities in Asia that meet the criteria. Such an intervention—on entrepreneurship and business innovation—would have the asset of focusing on some of the more prospective fields of SME endeavour, expected to be likely future elements in global value chains.

6. A research project relating to SME development and sustainable business (including corporate social responsibility), within the context of the globalization of production and global value chains. The project would seek to design a programme by which manufacturing SMEs in select countries or subregions of Asia and the Pacific could pursue more sustainable business practices, both for the direct benefits to be derived, and so as to meet the requirements of MNEs (for example, ISO 14000 accreditation). In turn, this would enable SMEs to better: (a) plug into international production networks; (b) establish linkages with foreign-invested enterprises; and (c) connect with international buyers. The fruits of the research could also extend to a series of guidelines and seminars for SMEs in specific business fields on how they could effectively pursue sustainable business practices (and higher corporate social responsibility standards). Again, it would be desirable to get MNEs directly involved in the project, at various levels, both for the expert inputs they could provide, and with an eye to the project serving as a platform for any subsequent follow-up efforts. The project could focus in particular on economies (or even subnational regions) expected to be impacted most from climate change, such as Viet Nam and islands in the Pacific.

7. Action to support SMEs in better understanding government agency procurement policies, and how they could better position themselves to take advantage of these policies. Relatively little has been done in this area, and conversely, relatively little has been done to encourage government agencies to put in place more transparent procurement policies that do not discriminate against SMEs. Thus, there would be utility in surveying government procurement policies in the economies of the Asia-Pacific region, from which: (a) a set of applied information guidelines could be issued for SMEs

in relevant countries; and (b) a set of detailed recommendations could be provided to individual governments on how they could make their procurement policies more SME-friendly, based on international best practices. With government spending poised to increase markedly in many Asia-Pacific economies, as part of various economic stimulus policies to counter the global slowdown, this could be a particularly timely and effective initiative.

8. Business-angel networks, which can be very useful in bringing both equity capital and expertise to high-growth SMEs, and at an appropriate scale that bridges the gap between bank lending and more conventional private equity financing. With regard to SME finance, little has been done in the Asia-Pacific region to try and establish such networks, which are quite common in Europe. Even when bank lending is abundant, SMEs need to ensure they do not take on too much debt financing, and must balance this with equity capital if they can. Therefore, a pilot project to try and establish one or more subregional or national business-angel networks would merit closer examination, likely working in conjunction with established business associations and/or cluster initiatives.

9. A project to look at how select economies might go about “dovetailing” their approaches towards FDI and SME development more closely, for mutual benefit. As pointed out in section 3 of this paper, there are very real and considerable synergies to be derived between SME sector development and foreign direct investment, most notably through backward linkages. And yet the strategies by which many developing economies in the Asia-Pacific region tend to support SME development are often independent from their FDI attraction strategies. Such an initiative might have the most impact in less developed or developing economies where FDI inflows are relatively strong, but where SME development activity is thought to be less effective, or vice versa.

10. An examination of the regulatory issue of SME closure and bankruptcy (perhaps an apt element on which to finish). The notion of expending energy on this issue, in support of SME sector development, might seem rather counter-intuitive at first glance. However, this is not the case when one considers that all SMEs have a life cycle of sorts. If it is excessively difficult or expensive to close an enterprise down, entrepreneurs may hesitate to set a new company up. Providers of capital (especially debt finance) will also be far more hesitant to provide funding if the mechanics of business bankruptcy—and taking possession of assets pledged as collateral—are unduly burdensome. Ideally, the orderly closure of enterprises needs to be as smooth as that of establishment, but this is rarely the case. Instead, enterprises in many Asia-Pacific developing countries go into a state of suspended animation, thereby sometimes preventing the efficient recycling of business assets. It also makes SME-related policymaking difficult because data on the SME sector is inaccurate, containing as it does many mothballed businesses. The next year or so is likely to see the number of company closures rise markedly, and now would be a good time to enact an initiative that seeks to assist select Asia-Pacific countries in improving the regulatory environment pertaining to SME closure.